MULTIMEDIA UNIVERSITY

STUDENT ID NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 3, 2018/2019

BFN3034 – BEHAVIOURAL FINANCE

(SECTION B01)

30 May 2019
9.00 A.M. – 11.00 A.M.
(2 Hours)

INSTRUCTIONS TO STUDENTS

1. This questions paper consists of 2 pages.
2. Answer **ALL** questions. The marks for each question are given in the question paper.
3. Please write your answers for all the questions in the answer booklet.

Answer ALL questions.

Question 1

(a) Identify one behavioural bias or trait that is most exhibited from statement (i) to (iii) below.

(i) Siti has carefully analysed the historical data and concluded that recessionary environments occur on average 20% of the time. Siti has incorporated this probability into her strategic asset allocation recommendations. When new information is presented by a co-worker showing that the actions of the central bank significantly affect the recession probabilities and that the new head of the central bank has announced tightening monetary conditions. Nonetheless, Siti goes on vacation without making any adjustments to her work. **(5 marks)**

(ii) Jarden Lee suffers from this behavioural bias when he thinks that it is more likely for a black number to "hit" after a series of red numbers have hit on a US Roulette table in his recent Las Vegas Casino visit. **(5 marks)**

(iii) Aziz Zaki does nothing out of excess fear that actions could be wrong. He attaches undue weight to actions of commission (doing something) and do not consider actions of omission (doing nothing). He has strong sense of regret and pain is stronger for acts of commission. **(5 marks)**

(b) Discuss risk averse and risk seeking behaviour. You are required to show these risk behaviour of utility functions in two different graph forms. **(10 marks)**

(c) Choose any TWO **(2)** of the following to discuss the behavioural biases and their impacts on investment decision making. You may use an example to illustrate.

(i) House money effect
(ii) Hot hand fallacy
(iii) Representativeness
(iv) Availability bias

(10 marks)

(Total: 35 marks)

Continued...

Question 2

(a) (i) Discuss the two main players, sophisticated investors and noise traders in the Shleifer model of noise trading. **(10 marks)**

(ii) Discuss the limits to arbitrage as pointed out by the Shleifer model.

(8 marks)

(b) Discuss rationality assumption used in economics and finance field. Subsequently, discuss how expected utility theory differs from expected value. **(12 marks)**

(Total: 30 marks)

Question 3

(a) You are required to discuss the fallacy that is most appropriate to describe the following survey result.

"Linda is 31 years old, single, outspoken, and very bright. She majored in philosophy. As a student, she was deeply concerned with issues of discrimination and social justice, and also participated in anti-nuclear demonstrations. About 90% of survey respondents choose Linda as bank teller and active in the feminist movement". **(7 marks)**

(b) Discuss framing in the prospect theory by using two (2) scenarios of an avoidable loss of life in Kahneman and Tversky's study. **(18 marks)**

(c) Discuss endowment effect stated by Daniel Kahneman, Jack L. Knetsch, & Richard H. Thaler. (1990). "Experimental Tests of the Endowment Effect and the Coase Theorem. Journal of Political Economy 98(6), 1325-1348. **(10 marks)**

(Total: 35 marks)

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